

The Advantages of Arbitration Over Litigation: An Application to Franchise Contract

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Abstract: Franchise disputes differ from other commercial disputes. One of the main objectives of the franchise business is to protect the honesty of the franchise structure and the franchisor's product which are the cornerstones of the business. At the same time, the franchise relationship is also paramount to the business model, and there is a strong encouragement to ensure that any disputes between the franchisor and the franchisee are resolved in a way that produces little interruption to the franchise business as possible. Many franchisors also carry on business in more than one jurisdiction. This article examines the advantages of arbitration over litigation as a mechanism for resolving franchise disputes. Since franchise agreements are usually, if not solely, prepared by franchisors with little or no involvement from the franchisees.

Key words: Law, Dispute, Agreement, Business

1. Introduction

Arbitration has been part of a dispute resolution landscape for a long time. It is frequently used by parties to franchise agreements who want to craft their own private manner of resolving any dispute between them. Arbitration is a binding legal process by which parties have, by written agreement, submitted a dispute between them to be resolved by a neutral third party. While arbitration clauses are now common in franchise agreements, even when there is no arbitration clause, arbitration agreements are sometimes negotiated after a dispute has arisen.

As noted by Lew, Mistelis and Kroll (Julia et al, 2003) the fundamental features of Arbitration as a practice or mechanism for dispute resolutions in contractual dealings (franchise agreements inclusive) are an alternative to national court, which serves as a private avenue for the settlement of the dispute between the parties and is being selected and controlled by the parties.

Arbitration is an alternative to, not a substitute to litigation where arbitrators play a judicial role provided they resolve the dispute by rendering a decision of a binding nature (Fourchard et al, 1999).

The use of arbitration clauses in franchise agreements has been increasingly common as

parties strive to avoid costly and time-consuming in litigation and maintain the business relation during the existence of the agreement. The aim of this work is to examine the pros and cons of selecting arbitration as a method of settling disputes in franchise agreement.

2. Arbitration in the Franchising Agreement

Many franchisors prefer to arbitrate all or a subset of their disputes that would arise in the franchise agreement, hence insert an arbitration clause so that in the event of any dispute, it will be resolved through arbitration instead of litigation (Mark et al, 2007). Many franchisors prefer to arbitrate disputes with their franchisees because of arbitration's informal hearing procedures, the privacy of the proceedings and the outcomes and the limited judicial review of arbitration awards.

A franchisor that needs to resolve his dispute with the franchisees through arbitration obviously wants to make the arbitration clause in the agreement clear enough to cover all the claims that may arise from the franchise relationship that needs to be arbitrated. That is to say, any arbitration agreement needs to identify the parties, the scope of the claims involved; who should appoint the arbitrator, the rules to be applied and the site of the arbitration. The sample provision that addresses the above raised questions can be seen below:

The parties hereby agreed as follows:

“All argument regarding the franchise arrangement or the breach thereof (including but not limited to contract, tortious liability and statutory rights) shall be resolved by the agreement under the auspices of (name of arbitration provider), pursuant to the (name of providers, applicable rules) and judgment rendered may be entered by court of commensurate jurisdiction thereof. The cost of the arbitration will be borne equally by the parties. The parties agreed that (city where franchisor is headquartered) shall be the site for all proceedings held under this section, and that both the franchisor and the franchisee should not initiate a class claims or consolidate the arbitration with any additional suits to which either of them is a party”. (Court & Kennedy, 2002)

Arbitration offers to the franchising parties the opportunity to enter in to a specialized dispute resolution forum in which experts from various field, (depending on the nature of the claim(s) referred to the arbitration) evaluate the pre-dispute conduct. This can provide important benefit in cases relating to difficult issues arising from the contract between the franchising parties. For example, compliance with expectations that the franchisee devote optimal (best, desirable) effort to local promotion or customer service may be easier to enforce in the arbitration settings than in the litigation process.

3. The Applicable laws in Arbitration Settings

Arbitration as a process by which a difference among the franchising parties as to their mutual legal rights can be determined with binding effect whenever the dispute arises by an arbitral tribunal which can either be domestic or international arbitration. It is a domestic arbitration where the dispute arises between a franchisor and a franchisee that lives in the same country and it becomes international arbitration where the parties' lives in different countries (Judy et al, 2012).

The applicable law in arbitration in the United States is the Federal Arbitration Act (FAA), while in Canada the applicable laws are Commercial Arbitration Act which applies to domestic franchise dispute and International Commercial Arbitration Act applies where at least one party of the franchise agreement is

outside Canada (Judy et al, 2012).

In Malaysia, the Kuala Lumpur Regional Centre for Arbitration (KLRC) governs the Institutional arbitration for domestic transactions, while the Singapore International Arbitration Chamber (SIAC) and the Hong Kong International Arbitration Centre (HKIAC) governs the international transactions (Sunil, 2012)

There is inherent right to arbitration, in each country arbitration is governed by the law of such state especially if the dispute relates to a domestic arbitration, but where the dispute resulting from the franchise agreement is that of international franchise, then the provisions of the New York Convention may be applied especially when such a state is a signatory to the New York Convention. Many countries in their arbitration laws followed the pattern of UNCITRAL as the Model law (Judy et al, 2012)

In Malaysia also, the Arbitration Act 2005 which is based on the UNCITRAL as a Model law is the legislation that applies to both domestic and international arbitration (Sunil, 2012)

In respect of a domestic arbitration where the seat of arbitration is in Malaysia, Section 30(1) of the said Act provides that the tribunal shall decide the argument in line with Malaysia's substantive law.

Section 30(2) of Arbitration Act 2005 further states that in respect of international arbitration, the arbitral tribunal shall decide the dispute between the parties by applying the parties' chosen law.

Section 30(3) of Arbitration Act 2005 indicates that any designation by the parties of the law of a given state shall be construed, unless otherwise expressed as directed referring to the substantive law of that state and not to its conflict of law.

Also section 30(2) of the Arbitration Act 2005, indicated in a dispute that arises from a franchise agreement the applicable law to the substance of the dispute between the franchisor and the franchisee is the agreed law by the franchising parties as may be contained in the arbitration clause of their agreement.

This further indicates that the franchisor and the franchisee have the advantage of choosing the laws to resolve their dispute through arbitration, but section 30(4) of the Arbitration Act 2005, provides that where the franchisor and the franchisee fails to indicate the applicable laws to their disputes, then the applicable law shall be determined by the conflicts of laws rules.

4. Advantages of Arbitration in Franchise Disputes

The advantages of arbitration as a means of resolving franchise disputes among others include the followings:

i. Privacy and Confidentiality

Arbitration in franchise disputes can be made private and confidential. That is to say, no documents of the proceedings can be access by the public and they are not allowed to attend the proceedings as well as the media so as to avoid publicity. These features can be very pleasing to franchisors because it help to protect sensitive commercial information and trade secrets from being exposed and minimizes the publicity of certain types of claims(Rebane et al, 2015) This includes misrepresentation, breach of franchise agreement or breach of good faith and fair dealing.

This is contrary to litigation where trials are heard by a judge in an open court who will likely have no experience or expertise in franchise matters (Georgios, 2004). But the arbitration clause can require that the arbitrator have specialized knowledge in franchise which will help greatly in an efficient and sound hearing in the arbitration proceedings.

Privacy and confidentiality as one of the advantages of arbitration can preserve the franchise relationship and allow the franchisor and the franchisee to maintain the relationship since their disputes are kept secret as contrary to litigation which takes place in an open court and their disputes becomes known to other franchisees in the franchise set up.

ii. Preservation of business relationships

Arbitration by its nature is less adversarial than litigation. It is more possible to leave previous business relationships, for example franchisor and franchisee, licensor and licensee, seller and buyer or employer and employee intact (Paradise, 1995). Therefore, if the franchise agreement has not been terminated and is still operating, there would be an ability to preserve the relationship where the proceeding in the arbitration results in final decision.

Arbitration reduces the chances that one party will tactically delay or extend the proceedings, thereby frustrating the other party.

In litigation the party that was subjected to these tactics is likely to avoid future business transaction with the opponent because of the hatred that resulted from the litigation

iii. Finality of decision

There is generally no appeal on the merits of a case decided through arbitration and even grounds for appeal on points of procedure are more limited than those obtainable in litigation (Dutson et al, 2012). For example in Canada, a franchise party's rights appeal against an arbitral award from a domestic arbitration that relates to the interpretation of a commercial contract in a franchise agreement are generally limited (Rebane et al, 2015).

In most jurisdictions, appeals from domestic arbitration are permitted from decisions on pure questions of law only with the consent of the franchise parties or leave of the court. Therefore, the general lack of appellate review in arbitration (arbitral award) can reduce cost and delay to the franchising parties even though this is more favorable to a party who won the case at the arbitration proceedings.

A franchisor and a franchisee who agree to arbitrate usually seek to minimize judicial intervention. They intend to restrict court involvement and avoid additional aspect of appellate review which is obtainable in litigation. That means that the franchisor and the franchisee prefer finality by choosing arbitration to govern their disputes.

iv. Party autonomy and procedural flexibility

In arbitration proceedings a franchisor and a franchisee can choose for themselves which rules are to apply in their disputes by the arbitrator as this is oppose to litigation where the judge applies the country's rules of private international law to determine the applicable law (WIPO, 1995). It is the general principles of contract law that parties have freedom to agree as to the terms that will govern their transaction and the terms are binding on the parties; this also applies to franchise agreements. Therefore the franchisor and the franchisee may tailor the rules to meet their specific needs which include the choice of law, jurisdiction and venue of the arbitration.

In franchise disputes, the parties may instruct the arbitrator to decide according to equity and good conscience or to follow the

general principles of law such as those applied by International tribunals. This ability to specify the applicable law offers particular advantages to the parties in franchise agreement which is not obtainable in litigation.

Conclusion

Arbitration generally enables the franchisor and the franchisee to have a greater control over the process than in litigation which can result in significant effectiveness. The ability to select an arbitrator who has particular experience or familiarity with franchise disputes can be an important benefit of arbitration to the parties.

However, not all types of franchise disputes are suitable to be resolved through arbitration. For instance, a franchise disputes over the use of trademarks and enforcement of post-termination obligations are best resolve through litigation.

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